

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM:SJ:POSTU-123688-02

date:

may 28, 2002

to: Examination Division - San Jose
Attn: Cherrilynn Lee, International Examiner

from: Laura B. Belote
Attorney (LMSB)

subject: **NONDISCLOSURE AGREEMENTS**

This memorandum responds to your informal request for advice on whether Revenue Agents should execute taxpayer-provided non-disclosure forms to protect from disclosure the taxpayer's disclosure of its property, proprietary information, business processes and business practices. In accordance with I.R.C. Sec. 6110(k)(3), this memorandum should not be cited as precedent.

CONCLUSION

The Service should not enter into taxpayer-provided nondisclosure agreements with examined taxpayers since the Federal statutory safeguards presently in place offer sufficient protections to taxpayers and are the exclusive means for preventing improper disclosure and use of such information.

LEGAL ANALYSIS

I.R.C. §6103 and the regulations thereunder establish a comprehensive scheme that governs the confidentiality and disclosure of returns and return information. The Code section prohibits the release of returns and return information except in those limited circumstances provided for in the statute. Under §6103(b), "returns" include tax or information returns (e.g., Forms 1040, 1120, 941, 1099), estimated tax declarations or refund claims, and any amendments or supplement, including supporting schedules, attachments, or lists which are supplemental to or part of the return which are required by, provided for, or permitted by Title 26 and which are filed with the I.R.S. by, on behalf of, or with respect to any person. "Return information" includes any information gathered by the

Service with regard to a taxpayer's liability under the Internal Revenue Code. See United States v. Barrett, 837 F.2d 1341 (5th Cir. 1988), cert. denied, 492 U.S. 926, reh'g denied, 493 U.S. 883 (1989). More specifically, return information includes:

- (1) The taxpayer's name, and/or mailing address, and/or identifying number (SSN or EIN); or
- (2) the nature, source, or amount of income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments; or
- (3) whether the return was, is being, or will be examined or subject to other investigation or processing; or
- (4) any part of any written determination or background file not open to public inspection under I.R.C. §6110 (I.R.C. §6110 provides that any written determination of the Service, including Chief Counsel advice, shall be open to public inspection); or
- (5) any other data;

and which is received by, recorded by, prepared by, furnished to or collected by the IRS with respect to a return or with respect to the determination of the existence or possible existence of liability or the amount of the liability of any person under Title 26 for any tax, penalty, interest, fine, forfeiture, or other imposition or offense. I.R.C. §6103(b). Thus, the term "return information" is broad and includes any information gathered by the Service with regard to a taxpayer's liability under the Internal Revenue Code. Chamberlain v. Kurtz, 589 F.2d 827 (5th Cir. 1979), cert. denied, 444 U.S. 842 (1979).

I.R.C. §6103 has been held to be the exclusive means for gaining access to Federal tax information. See e.g., Lake v. Rubin, 162 F.3d 113 (D.C. Cir. 1998), cert. denied, 119 S. Ct. 1465 (1999). See also Stokwitz v. United States, 831 F.2d 893 (9th Cir. 1987) (stating that I.R.C. §6103 provides "the only means for acquiring" tax information from the Service). If either an I.R.S. employee or third party expert made an unlawful disclosure in violation of I.R.C. §6103, Federal statutes provide for both civil and criminal penalties. I.R.C. §7431(a)(1) permits a taxpayer to bring a civil action for damages against the United States in a Federal district court for any unauthorized disclosure of tax information made knowingly or by reason of negligence by an officer or employee of the United States. If the unauthorized disclosure was made by a person who is not a government employee or officer, the taxpayer may sue that person in district court in accordance with I.R.C. §7431(a)(2). The taxpayer can recover the greater of \$1,000.00 for each act of unauthorized disclosure of tax information or the

sum of actual damages as well as, in the case of a willful disclosure or a disclosure that is the result of gross negligence, punitive damages. Moreover, under I.R.C. §7431, a plaintiff may recover reasonable attorney fees, if the plaintiff is the prevailing party and the plaintiff's net worth does not exceed certain prescribed dollar amounts, and litigation costs.

In addition to the civil remedies available to the taxpayers, other Federal statutes serve as a safeguard for the protection of tax return information by imposing severe criminal penalties for willful unauthorized disclosure or inspection of returns and return information. For example, I.R.C. §7213 provides that any Federal employee or contractor to whom tax information has been disclosed for tax administration purposes, who willfully discloses return information in violation of I.R.C. §6103 shall be guilty of a felony punishable by a fine of up to \$5000 and imprisonment for up to five years. I.R.C. §7213(d) also makes it a felony punishable by fine of up to \$5000 and imprisonment for up to 5 years to willfully disclose software in violation of I.R.C. §7612.¹ Under I.R.C. §7213A, willful unauthorized inspection of returns and return information by a government employee or a I.R.C. §6103(n) contractor (e.g., an outside expert hired by the Service) is a crime punishable by a fine not to exceed \$1,000, imprisonment up to one year, or both.

Thus, the provisions and sanctions of I.R.C. §§ 6103, 7431, 7213 and 7213A are adequate protection for taxpayers and are the exclusive means of redress for unauthorized inspection and disclosure of returns and return information. There is an additional concern that taxpayer-provided nondisclosure agreements could potentially conflict with section 6103. For example, I.R.C. §6103 provides certain limited exceptions to the general nondisclosure rule; taxpayer-provided nondisclosure agreements may not contain provisions for such exceptions. As a result, the additional nondisclosure agreements could create unnecessary complexity and conflict. Thus, Service employees

¹ I.R.C. §7612(a)(2) also provides specified protections for any software and related materials provided in an audit which produce or analyze tax related software source code. These protections are enumerated in I.R.C. §7612(c) and include authorization to Courts to issue protective orders in summons enforcement proceedings to protect trade secrets, limitation on use of software to a single taxpayer's return for which it was produced, maintenance of software in a secure place, limitations on copying, and treatment of the software as return information under I.R.C. §6103.

should not sign additional nondisclosure agreements imposed upon them by the taxpayer.

We have contacted David L. Fish, Chief of Branch One, Disclosure and Privacy Law (CC:PA:DPL:B1) to obtain his interpretation of the issue. Mr. Fish agreed that the principles of the expert witness memorandum,² which our office recently provided to you, would also apply to I.R.S. employees with respect to the taxpayer-provided nondisclosure agreements. Although we have spoken to Mr. Fish, please note that we have forwarded a copy of this memorandum to our National Office to ensure that the above analysis is consistent with the National Office position. We will notify you within approximately two weeks if the National Office believes that our analysis should be revised.

If you have any questions or concerns, please do not hesitate to contact the undersigned attorney at (408) 817-4694.

M. KENDALL WILLIAMS
Associate Area Counsel
CC:LM:CTM:SJ

By: _____
LAURA B. BELOTE
Attorney
CC:LM:CTM:SJ

cc: Office of Chief Counsel
Technical Services Section
Room 4510

² ILM 200128055 (31 May 2001).